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SUBJECT: NICARAGUA: INPUT FOR THE SEVENTH CBERA REPORT

REF: SECSTATE 143212

¶1. As requested in reftel, the following is post's input for the Seventh Report on Caribbean Basin Economic Recovery Act (CBERA).

Statistical Information

¶2. Population (2006, estimate): 5,457,000 (Nicaraguan National Statistics and Census Office)

Real GDP per Capita (2006, estimate): $958 (Nicaraguan Central Bank)

Department of Commerce 2006 Trade Statistics
U.S. Exports: $705.3 million
U.S. Imports: $1,526.1 million
U.S. Trade Balance: -$820.7 million

Economic Review

¶3. From 1991 to 2006, three successive Liberal Party governments focused on free market reform as a path to recovery from 12 years of economic free-fall under the Sandinista regime and civil war. Before Daniel Ortega's return to the presidency in January 2007, the government had privatized more than 350 state enterprises, reduced accumulated year-on-year inflation from 33,548% in 1988 to 9.45% in 2006, and cut foreign debt by two-thirds. In 2006, real GDP growth was 3.7 %. Exports have been a key engine of economic growth, topping $1.98 billion in 2006 (including free trade zones). Foreign capital inflows were $282.3 million in 2006. Nicaragua's economy is based primarily on agriculture and agricultural processing. Other sectors such as light manufacturing (apparel), tourism, banking, mining, fisheries, and retail are also important.

¶4. Despite these advances, Nicaragua remains the second-poorest nation in the hemisphere. Unemployment is officially estimated at 5% of the economically active population, but an estimated 60% of workers belong to the informal sector. Nicaragua suffers from persistent trade and budget deficits and a high internal debt-service burden. Foreign assistance comprised 26% of the budget in 2006. Nicaragua also depends heavily on remittances from Nicaraguans living abroad, who transferred $655.5 million to Nicaragua in 2006.

¶5. The Sandinista National Liberation Front (FSLN) economic team has promised to continue policies that engender a stable macroeconomic environment, and in July 2007 the government signed a Poverty Reduction and Growth Facility (PRGF) with the International Monetary Fund (IMF) that requires the implementation of free-market policies and includes targets linked to fiscal discipline, spending on poverty, and regulation of the energy sector. However, President Ortega's continues to publicly criticize the "neo-liberal" economic

model and a perceived lack of support from the private sector in reducing poverty. A lack of clear policy direction, the spotty application of the rule of law, and continued battles over property rights have created uncertainty for the private sector and has complicated investment decisions. Yields on domestic, cordoba-denominated government debt have risen sharply since Ortega took office, reflecting the higher risk that debt now carries owing to the government's unclear economic orientation.

Commitment to Trade Liberalization

¶6. Nicaragua has been an active participant in the World Trade Organization (WTO) Doha Development Agenda. In 2002, the country completed a broad package of tariff reductions launched in 1997 and adopted a WTO-consistent customs valuation methodology. The WTO's 2006 Trade Policy Review for Nicaragua recognizes that the country has made substantial progress in modernizing its legal and regulatory framework to comply with WTO commitments.

¶7. Nicaragua, along with Costa Rica, El Salvador, Guatemala, and Honduras, is a member of the Central American Common Market (CACM). With the exception of agricultural products, these countries have harmonized all external tariffs at 15 percent or less. Members have also made significant progress in modernizing customs administration to facilitate trade within the region.

¶8. On August 5, 2004, Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, and the United States signed the Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR). The CAFTA-DR entered into force for Nicaragua and the United States on April 1, 2006. The agreement removes barriers to trade and investment in the region and provides impetus to further regional economic integration. The CAFTA-DR requires that the Central American countries and the Dominican Republic undertake needed market liberalization as well as greater transparency and certainty in customs administration, protection of intellectual property rights, services, investment, financial services, government procurement, and sanitary and phytosanitary (SPS) measures. Nicaraguan exports to the United States grew 17.4% during in the first 12 months following the implementation of the CAFTA-DR, including the export of 237 products not previously exported to the United States. Imports from the United States increased 22.1%, with machinery, cereals, vehicles, vegetable oils, and plastics leading the way.

¶9. Nicaragua and other CACM members have negotiated separate bilateral trade agreements with the Dominican Republic and Mexico. Other CACM members have implemented bilateral trade agreements with Chile, but Nicaragua's negotiations have stalled over trade in sugar. CACM members are also negotiating trade agreements with Canada, the European Union, Panama, and Taiwan.

Protection of Intellectual Property

¶10. To implement the CAFTA-DR, Nicaragua has strengthened its legal framework for the protection of intellectual property rights. The agreement provides improved standards for the protection and enforcement of a broad range of intellectual property rights, which are consistent with U.S. intellectual property standards and with emerging international standards. Such improvements include state-of-the-art protections for digital products such as software, music, text and videos; stronger protection for patents, trademarks and test data, including an electronic system for the registration and maintenance of trademarks; and further deterrence of piracy and counterfeiting.

¶11. Nicaraguan efforts to enforce intellectual property law remain limited. During the first ten months of 2007, the Nicaraguan Government had conducted 20 raids and the police seized 58,547 pirated DVDs, 21,629 CDs, 13 computers, 3 multi-purpose copiers, and other audiovisual equipment worth approximately $123,000. On July 13, 2007, the Nicaraguan Government successfully prosecuted a case in a local court against a Nicaraguan selling pirated music CDs. The offender was sentenced to two years in prison--later reduced to parole--and fined 5,000 cordobas ($267). The Prosecutor General and National Police are currently investigating 28 intellectual property

cases for possible prosecution.

Provision of Internationally Recognized Workers Rights
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¶12. Nicaraguan law grants public and private sector workers, except those in the military and police, the right to organize. Workers need not advise the employer or the Ministry of Labor of their intention to do so. In general, workers exercise the right to organize unhindered. However, labor activist allege that some business operating in free trade zones violate this right. Although employers are legally required to reinstate workers fired for union activity, formal reinstatement requires a judicial order. In practice, employers often do not reinstate workers due to weak enforcement of the law. Employers may dismiss any employee, including union organizers, by agreeing to pay double the legally mandated severance pay.

¶13. The law provides for the right to bargain collectively. By law, several unions, each with different membership, may coexist at any one enterprise. Employers may sign separate collective bargaining agreements with each union. Labor leaders complain that employers routinely violate collective bargaining agreements and Nicaraguan labor laws. Although the law recognizes the right to strike, according to Labor Ministry information, there were no legal strikes in 2006. The law contains burdensome and lengthy conciliation procedures before calling a strike. During a strike, employers cannot hire replacement workers. According to the law, the Ministry of Labor may suspend a strike if it continues for 30 days without resolution. At that point, parties are required to resolve their differences through arbitration.

¶14. The law prohibits any type of forced or compulsory labor. The statutory minimum wage is set through tripartite negotiations involving business, government, and labor and must be approved by the National Assembly. Each sector of the economy has a different minimum wage, which must be reviewed every six months. In general, the minimum wage is enforced only in the formal sector. The maximum legal workweek is 48 hours. While the law mandates premium pay for overtime and prohibits excessive compulsory overtime, these requirements are not always effectively enforced.

¶15. The law establishes occupational health and safety standards, but the Ministry of Labor lacks adequate staff and resources to fully enforce these provisions. The law provides workers with the right to remove themselves from dangerous workplace situations without jeopardizing continued employment, but many workers are unaware of this right. The Nicaraguan Center for Human Rights (CENIDH) receives frequent complaints related to working conditions.

Commitments to Eliminate the Worst Forms of Child Labor
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¶16. The worst forms of child labor are prohibited under several laws in Nicaragua. The Constitution bans forced labor, slavery, and indentured servitude. Nicaraguan law provides for the protection of children's rights and prohibits any type of economic or social exploitation of children. Labor law sets the minimum age for employment at 14 years and limits the workday to six hours. Children between the ages of 14 and 16 must have parental approval to work. Annually, the Ministry of Labor identifies types of work that are harmful to the health, safety, or morals of children under International Labor Organization (ILO) Conventions 182 and 138.

¶17. Child labor remains a widespread problem, and many children--particularly those working in small family-owned businesses--do not receive direct compensation for their labor. Labor activists report that cigar factories continue to employ many children, a violation of Article 84 of the Constitution, which prohibits the use of child labor in activities that may affect their normal development and education. Although the law imposes fines for violators and permits inspectors to close facilities employing child labor, the Ministry of Labor lacks adequate resources to effectively enforce the law, except in the small formal sector.

¶18. From 2001 to 2005, the Nicaraguan Government and the ILO implemented a Strategic National Plan for the Prevention and Eradication of Child Labor and Protection of Youth Workers. With

the support of international donors, the program provided educational, medical, and nutritional support to 100,000 children living in poverty and more than 14,000 children engaged in the worst forms of child labor. In 2007, the Nicaraguan Government prepared a 10-year follow-up plan with the ILO.

Counter-Narcotics Cooperation

¶19. Nicaragua is not a major drug transit or major illicit drug producing country under the terms of the 2003 Foreign Relations Authorization Act and is not subject to the act's certification requirements. Nevertheless, Nicaragua is an important transit point for drugs moving from South America to U.S. and European markets. The government has been an important partner in efforts to stem the flow of drugs.

Anti-Corruption Efforts

¶20. Nicaragua is a signatory to the Organization for Economic Cooperation and Development (OECD) Convention on Combating Bribery, as well as the Inter-American Convention against Corruption (IACC). The government is an active participant in the Organization of American States' Follow-up Mechanism for the Implementation of the IACC. Under that mechanism, a 2006 Committee of Experts report notes significant progress in implementing the convention, but recommends further improvements in civil service hiring, procurement, whistleblower protection, standards of conduct, financial disclosure for senior officials, oversight bodies, and civil society participation.

¶21. The Attorney General and the Controller General have responsibilities for investigating and prosecuting corruption cases. The application of justice is uneven, and there is general acknowledgement that the judicial system is corrupt and controlled by political interests. Corruption and influence-peddling in the judicial branch put foreign investors at a sharp disadvantage in any litigation or dispute, and legal security for business in general is among the weakest in Latin America. The concept of conflict of interest is poorly understood, to the extent that regulators often maintain business interests in sectors that they oversee. Political connections and nepotism often affect regulatory decisions and business decision-making.

¶22. Nicaragua has made progress in prosecuting cases of corruption, but public opinion surveys show that Nicaraguans believe corruption remains endemic in many government institutions, including the judiciary, the National Assembly, the Supreme Electoral Council (CSE), the Controller General, the Human Rights Ombudsperson (PDDH), and the Attorney General. Under the Bolanos administration, the Attorney General indicted former president Arnoldo Aleman and other officials of his administration on money laundering, embezzlement, and other charges. In December 2003, a local court sentenced Aleman to a 20-year jail term. By expanding the terms of Aleman's house arrest, the Ortega Administration has allowed Aleman to travel freely throughout Nicaragua since March 2007. The National Assembly is considering legislation that would effectively reduce Aleman's sentence to five years.

Transparency in Government Procurement

¶23. The CAFTA-DR requires the use of fair and transparent procurement procedures, including advance notice of purchases and timely and effective bid review procedures, for procurement covered by the agreement. Under the CAFTA-DR, U.S. suppliers may bid on procurements made by most Nicaraguan Government entities, including key ministries and state-owned enterprises, on the same basis as Nicaraguan suppliers. To make its bidding process more transparent and efficient, Nicaragua launched a computer-based procurement system in November 2006. The anti-corruption provisions in the CAFTA-DR require each government to ensure under its domestic law that bribery in matters affecting trade and investment, including government procurement, is treated as a criminal offense, or is subject to comparable penalties. Nicaragua is not a signatory to the WTO Agreement on Government Procurement. Procurement by government agencies not covered by CAFTA-DR, as is the case for the

National Electricity Company, remain subject to nontransparent and irregular procurement procedures.

Nationalization/Expropriation

¶24. Thousands of individuals and companies, including many U.S. citizens, have filed claims for compensation for property confiscations that took place during the 1980s under the Sandinista government. Since 1995, the Nicaraguan Government has made continuing progress in settling claims through compensation or return of properties. As of September 2007, the Nicaraguan Government has settled more than 4,500 U.S. citizen claims. A total of 677 Embassy-registered U.S. claims remain outstanding. In 2006, the Bolanos administration resolved 81 Embassy-registered U.S. citizen property claims, primarily through compensation. As of November 1, 2007, the Ortega administration has resolved five Embassy-registered claims, all belonging to one U.S. citizen. The courts resolved two other claims.

¶25. In August 2007, the Nicaraguan Government seized, via a judicial order, several petroleum storage tanks owned by a U.S. company on the pretext that the company had not paid value-added taxes associated with the import of crude oil, despite the fact that unrefined petroleum is not subject to this tax and no mechanism exists to collect it. The government then used the tanks to store petroleum products from Venezuela. The government has ignored due process to declare a number of concessions in the energy sector effectively invalid, forcing companies, including some U.S. companies, to renegotiate terms.

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